

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Promote Policy
and Program Coordination and Integration in
Electric Utility Resource Planning.

Rulemaking 04-04-003
(Filed April 1, 2004)

**ASSIGNED COMMISSIONER'S RULING PROVIDING FOR
COMMENTS AND REPLIES ON MODIFICATION TO THE
INTERIM RESOURCE ADEQUACY REQUIREMENTS (RAR)
DECISION (D.) 04-10-035**

1. Summary

This ruling provides an opportunity for parties to submit comments and replies on possible modifications to D.04-10-035 that pertain to the nature of the forward commitment obligation. As this is a threshold issue whose resolution could significantly impact the consideration of other issues in Phase 2 of the RAR track of this rulemaking, comments and replies shall be filed on an expedited schedule as set forth below.

Opening Comments February 18, 2005

Reply Comments February 23, 2005

This schedule is designed to enable the Commission to issue a timely decision on whether, and if so how, to modify D.04-10-035 to address the issues discussed in this ruling. This will in turn promote the fair and efficient consideration of the issues in Phase 2.

2. Background

D.04-01-050 adopted key policies for RAR that are applicable to the three major investor-owned utilities, energy service providers, and community choice

aggregators (collectively, load serving entities or LSEs). In adopting these policies, the Commission said that it was “providing a framework to ensure resource adequacy by laying a foundation for the required infrastructure development and assuring that capacity is available when and where it is needed.” (D.04-01-050, p. 11.) Among the RAR policies adopted in D.04-01-050 are the following:

- Each LSE has an obligation to acquire sufficient resources and reserves to cover its customers’ loads.
- Each LSE is subject to a planning reserve margin requirement of 15-17% for all months of the year.
- Each LSE must forward contract 90% of its summer (May through September) peaking needs (loads plus planning reserves) a year in advance.

D.04-10-035, the *Interim Opinion Regarding Resource Adequacy*, was issued in this docket to provide definition and clarification with respect to the RAR policy framework adopted in D.04-01-050. Among other things, D.04-10-035 instituted a year-round 100% “month-ahead” obligation as an overlay to the 90% “year-ahead” obligation for the summer months. The month-ahead obligation requires a showing that the remaining 10% of resources have been acquired for each of the five summer months and that all of the necessary resources have been acquired for the other seven months.

While D.04-01-050 and D.04-10-035 established a resource adequacy policy framework, the latter decision left for resolution in Phase 2, which is currently underway, important implementation details such as compliance, sanctions, locational procurement, load forecasting conventions, the relationship between the year-ahead and the month obligation, and the precise nature of the system support requirements that all qualifying resources must satisfy. On November 4,

2004, the assigned Administrative Law Judge issued a ruling initiating a workshop process to resolve the outstanding issues in Phase 2.

3. Discussion

In the course of the workshops it has become apparent that a portion of D.04-10-035 requires clarification. Section 3.1 (“Nature of the Obligation to be Satisfied” at pp. 9-11) contains inconsistent passages explaining the nature of the reserve obligation that LSEs must satisfy to fulfill the resource adequacy requirement. For example, the following statements appear to support the interpretation that resources must be acquired to meet load plus reserves for every hour of every month of the year:

“While D.04-01-050 did not require a 90% forward commitment for the non-summer months, we clarify here that the 15-17% reserve requirement applies to the entire year. Indeed, anything short of a year round reserve requirement would constitute sub-optimal and inadequate assurance of grid reliability.” (D.04-10-035, p. 9.)

* * *

“The resources that “stack up” to satisfy load and the 15-17% PRM for each hour of a month can be different.” (*Id.*, p. 11.)

While the above language indicates that the RAR obligation applies to each hour of the year, other language within Section 3.1 can be read to require a more limited obligation, one that applies to defined peak periods:

“[The California Independent System Operator (CAISO)] in its reply comments suggests that the obligation be for those hours in which load is greater than or equal to 90% of peak load. Examining historical data, CAISO identifies a range of 10-12 hours per year in which system load is 90% or greater of the absolute peak for that year.....Thus, we will require that LSEs acquire a mix of resources capable of satisfying the number of hours for each month that their

loads are within 10% of their maximum contribution to monthly system peak.” (*Id.*, p. 10).

The more limited reading of D.04-10-035, however, is inconsistent with CAISO market design. The Commission recognized this in D.04-10-035 by further requiring that resources nominated to satisfy the resource adequacy obligation be made available to satisfy CAISO needs as a replacement for the current Federal Energy Regulatory Commission (FERC)-ordered “must offer” requirements. Section 3.8.2 says:

“Clearly, the LSE who has a contract with a generator should have first call on that generator, but if the system demands that a generator be called upon for the benefit of the system, then the generator must be required to operate. A sequence of requirements to first be scheduled by the LSE, then to bid into Day-Ahead markets if not scheduled, and then be subject to [residual unit commitment (RUC)] if the bid is not accepted is appropriate. We adopt this as our policy going forward.” (*Id.*, p. 41.)

Given the inconsistencies described above, and their impact on the requirement that qualifying resources be made available to the CAISO, it appears to be necessary to modify D.04-10-035 to further clarify the nature of the forward commitment obligation. Moreover, it has become apparent that the alternative interpretations of the nature of the obligation have substantial impacts upon the various implementation details being established in Phase 2. Until this question is resolved, parties as well as staff could invest excessive time and resources in Phase 2 devising alternative implementation packages.

Staff’s intent was to develop a reserve requirement that both (1) ensured that resources necessary to serve load would be available when needed, and (2) complemented the ISO market design, thus replacing the current must-offer obligation. The more limited reading of the reserve requirement suggested by the “90% of peak load” language quoted above does not appear to meet these goals.

For a system of resource adequacy requirements to meet its objectives, it is necessary to ensure that resources that are required to meet peak loads be able to recover their fixed costs so that they are available when they are necessary to meet load.¹ Making sure that resources that are required to meet peak loads recover their costs – that is, providing for a measure of “revenue adequacy” – can be accomplished by creating capacity payments to supplement energy payments. Capacity payments are one way to compensate a resource that makes itself available to the CAISO through an obligation to bid or schedule day-ahead into the CAISO so that the CAISO can call on resources when and where needed to meet system needs.²

Absent a mechanism for at least partial recovery of the carrying costs of capacity, resources necessary to meet load would have to recover the balance of their costs in a limited number of hours or months of run time per year at very high prices.³ A more stable means to ensure that California has the resources it

¹ Providing for the recovery of the carrying cost of resources needed to meet peak conditions is consistent with traditional practices. Utilities have historically included in rate base the cost of units required to meet “1 in 10” conditions. The carrying costs of resources that are required to maintain reliability in low hydro years or high load periods are more transparent now than prior to deregulation. There is no reason that we should accept lower than historic levels of reliability now than prior to deregulation.

² Eastern markets have annual resource adequacy requirements where LSEs must procure capacity to meet summer peak loads throughout the year. The reasoning behind the requirement is that there is a substantial amount of capacity that is required to meet summer peak that will not recover its costs throughout year absent a capacity requirement. Absent the year-round capacity payment, that peaking resource would have to recover all its annual costs from the energy market in a limited number of runtime hours at very high prices.

³ The Commission has maintained that a substantial portion of fixed costs recovery should take place through forward contracts as opposed to energy markets. Indeed,

Footnote continued on next page

requires to meet system conditions is through a Resource Adequacy requirement that increases the likelihood that needed resources remain economically viable to perform when needed.

Resource adequacy requirements are intended to diminish if not eliminate the must-offer requirement established by FERC in its June 2001 order.⁴ Today, the CAISO has access to must-offer resources every day. In other words, the CAISO can call upon these resources whenever they are required to meet operational needs. The CAISO currently commits must-offer resources in the day-ahead timeframe and requires these resources in peak and non-peak times of the year. I note the intention that resources be scheduled or bid into the CAISO in the day-ahead timeframe.⁵ This is the critical link between the capacity obligation and energy markets. That is, all such resources must be available to the CAISO through a bid by the qualifying generating resource into the forthcoming Day-Ahead market. The CAISO's ability to call on a resource is the nature of the capacity obligation. LSEs can and should structure their energy purchases to cater to their load profiles.

Finally, the alternative interpretations identified in this ruling have implications for load forecasting requirements, reporting details, and review/adjustment that may seriously affect what the Commission will require from each LSE. For example, the language suggesting that only loads greater

this approach is consistent with the Commission's position in various FERC filings supporting the \$250 price cap.

⁴ San Diego Gas & Electric, et al., 95 FERC 61,418 (2001).

⁵ The generator has an obligation to bid into the day-ahead market by virtue of qualifying as a resource eligible to meet the capacity requirement. (D.04-10-035, p. 41.)

than 90% of peak require reserves necessitates identifying these hours. This leads to a possible need to adjust each individual LSE's load forecasts for coincidence with overall control area loads. Similarly, a focus only on near-peak loads, whether those are within 10% of the LSE's own peak or the CAISO control area peak, diminishes attention to accurately forecasting and reporting off-peak loads. Not only do these alternatives involve changes of emphasis for how LSEs devote resources to preparation of hourly load forecasts, they also alter the nature of the review process and the timeline for load forecasts that the California Energy Commission has agreed to undertake as part of our collaboration on planning and procurement matters.

4. Provision for Comments and Replies

A timely Commission decision clarifying the nature of the RAR obligation should promote more efficient consideration of the other Phase 2 issues. I therefore invite parties to submit comments on how D.04-10-035 might be modified to resolve this question. With LSEs responsible to acquire resources to serve load and cover PRM for all hours of the year, there are at least two alternative ways that the issue may be resolved.

- Reserves constant at level of peak load for the Month
- Reserves constant at level of annual peak

Comments should address the options available in achieving the capacity based obligation that the Commission established in D.04-10-035. Comments should also provide a rationale for the preferred option and discuss the ramifications for the overall resource adequacy requirements being developed through the workshop process.

IT IS RULED that:

1. Comments and supporting rationale may be filed in accordance with the foregoing discussion and are due February 18, 2005. Replies to comments may be filed and are due February 23, 2005.

2. Pursuant to Pub. Util. Code § 1708, this ruling shall constitute notice to parties that Decision 04-10-035 may be modified on the basis of comments and replies submitted pursuant to this ruling.

Dated February 8, 2005, at San Francisco, California.

/s/ MICHAEL R. PEEVEY

Michael R. Peevey
Assigned Commissioner

CERTIFICATE OF SERVICE

I certify that I have by mail, and by electronic mail to the parties to which an electronic mail address has been provided, this day served a true copy of the original attached Assigned Commissioner's Ruling Providing for Comments and Replies on Modification to the Interim Resource Adequacy Requirements (RAR) Decision (D.) 04-10-035 on all parties of record in this proceeding or their attorneys of record.

Dated February 8, 2005, at San Francisco, California.

/s/ FANNIE SID

Fannie Sid

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.